



LEGAL UPDATES

South Dakota Supreme Court Limits Ability of Trust Beneficiaries to Sue on Behalf of Trust

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In a recent opinion, the South Dakota Supreme Court held that trust beneficiaries lacked standing to bring claims against a third party on behalf of the trust. In so holding, the court explained that trustees typically are the only parties with standing to bring claims on behalf of the trusts they administer, and it declined to adopt a broader exception to this rule urged by the beneficiaries. This ruling has important implications for trustees and trust beneficiaries alike.

The Opinion

In *Matter of Estate of Calvin*, 2021 S.D. 45, the remainder beneficiaries of a trust alleged that the primary beneficiary, John Calvin, had improperly received over \$700,000 in principal distributions from the trust in the final years of his life. According to the remainder beneficiaries, these distributions had been contrary to the terms of the trust and were fraudulently induced by Calvin. Upon Calvin's death, the remainder beneficiaries filed a creditor claim with his estate, seeking to recoup these lost principal distributions and the consequent lost earnings. The personal representative of Calvin's estate disallowed the claim, and the beneficiaries brought suit in circuit court.

The personal representative moved to dismiss on several grounds, arguing in part that the remainder beneficiaries lacked standing because their claim belonged to the trust and could only be brought by the trustee. The beneficiaries countered that the alleged improper principal distributions had caused them a direct injury sufficient to confer standing. Although the circuit court granted the motion to dismiss, it did so on the merits of the beneficiaries' claim, and not on the standing issue.

The South Dakota Supreme Court affirmed, but it elected to do so on the standing issue and not on the merits. Noting that standing requires some actual or threatened injury resulting from the defendant's conduct, the court observed that the harm the beneficiaries alleged stemmed not from actions directed at them by Calvin, but instead from misrepresentations Calvin allegedly made to the trustee. Under these circumstances, the court held the trustee—not the beneficiaries—was the real party in interest to pursue the claims. The court noted that this ruling aligned with the general common law rule that a cause of action on behalf of the

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trust belongs to the trustee. The court also noted an exception to this rule applies when the trustee is unable, unavailable, unsuitable, or improperly fails to protect the beneficiary's interest, but this exception did not apply because the beneficiaries made no such allegations.

At the urging of the beneficiaries, the court considered one additional exception to the trustee-standing rule that was recently recognized in California: that "when a third party has assisted a trustee in a breach of trust, the beneficiaries may bring suit against both the trustee and the third party, but it is not necessary to join the trustee in the suit because primarily it is the beneficiaries who are wronged and who are entitled to sue the third party." The court declined to adopt this broader exception in South Dakota, expressing fear that to do so would "eviscerate" the general rule that all actions concerning a trust belong to the trustee in the first instance.

What It Means

Trustees and beneficiaries alike should take note of *Estate of Calvin*. For the moment at least, the South Dakota Supreme Court has narrowed the ability of trust beneficiaries to bring claims on behalf of a trust—a movement that has gained some traction of late in other jurisdictions. In doing so, the court also increased the level of control trustees have over trust claims, and it further limited beneficiary-rights in an already trustee-friendly jurisdiction. Whether the approach espoused by the South Dakota Supreme Court will prevail nationally over the more permissive approach adopted in California remains to be seen.

For the unwary trustee, however, this increased level of control over claims may prove to be a double-edged sword. In limiting the ability of aggrieved beneficiaries to seek redress from third parties for harms caused to a trust, the *Calvin* decision will increasingly push beneficiaries to look to the trustee for their remedy—likely through breach of fiduciary duty or related claims.

In order to manage risks associated with these types of breach of fiduciary duty claims, trustees should be diligent in responding to beneficiary concerns of third-party misconduct, and in considering possible claims against third parties on behalf of the trust. As always, prudence, process, and documentation of the trustee's investigation and analysis will be important in demonstrating fiduciary duties were fulfilled. Trustees should continue to consider seeking court approval of annual accounts as a way to close out fiduciary risk—especially where a controversial decision may be involved.

Likewise, beneficiaries should promptly notify trustees of claims against third parties and, if the trustee elects not to pursue the claims, be prepared to demonstrate the trustee is unable, unavailable, unsuitable, or improperly failing to protect the beneficiaries' interests in order to have standing to bring the claims themselves on behalf of the trust.

Fiduciary duties are complex and litigation involving trusts and trustees is increasing. Hiring an attorney to help navigate these potential pitfalls can be useful. If you have questions about *Estate of Calvin* or want to discuss a trust that you are administering or a beneficiary of, please contact Jim Thomson or your regular Lathrop GPM Trust, Estates & Legacy Planning contact.